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MEMORANDUDM FOR: Director of Central Intelligence
Deputy Director of Central Intelligence

VIA : Chairman, National Intelligence Council

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SUBJECT : Soviet Hard Currency Position in 1982: A Change in Mood

1. The serious erosion in the Soviet hard currency position that has been well described in recent intelligence commentary* raises the question of whether the new situation will significantly constrain Soviet policies or actions in the new year.

2. An Earlier Crunch. A hard currency bind is, of course, nothing new in Soviet experience. The last time the USSR found itself in a worrisome current account position -- in the mid-seventies -- it managed to work its way out of it fairly easily. Faced with large trade deficits incurred in 1975-76 and a potential threat to its vaunted creditworthiness rating, the USSR State Bank moved quickly to impose discipline upon its Euroborrowing and slowed down the growth of its imports. By the end of 1978, its current account was back in surplus and the confidence of Western money markets had been reaffirmed. But the problem then was easy:

3. The Lucky Seventies. The broad expansion of Soviet trade during the decade of the Seventies and Moscow's success in 1977-78 in regaining control over its hard currency balance of payments were greatly facilitated by several unique circumstances:

- Large windfall gains derived from a dramatic improvement in the Soviet terms of trade in convertible currencies -- largely oil-price related -- and from a sharp runup of gold prices to dizzying heights in 1979-80.

- A steady redistribution of wealth towards OPEC countries whose appetite for modern weapons opened up a new hard currency market for Soviet arms.

* "USSR in Hard Currency Squeeze" in IEEW 20 November 1981, Page 1; "Soviet Hard Currency Situation", Memo for DCI from NIO for Economics, 18 December 1981.

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need for food imports to maintain barely acceptable living standards and for technology imports to bolster lagging productivity; a politically irreducible level of subsidization of client states, particularly of Eastern Europe and Cuba; and the potentially staggering burden of having to sustain even a penurious viability in Poland (Romania? East Germany?) for years to come.

6. Implications. The Soviet leaders are surely aware of these growing financial strictures and their calculations are bound to be influenced by the constraints they impose. While the USSR is not on the brink of a financial disaster, it now faces politically tough choices on a number of key issues:

- How much hard currency earnings to sacrifice on the altar of subsidies to client states (how much low priced oil to Eastern Europe; high-priced sugar from Cuba?)
- Whether to shoulder additional foreign commitments that may impose burdensome financial drains (how many more Afghanistan and Vietnam sink holes?)
- How "concessional" to make arms sales (how many more multi-billion dollar arms "sales" that are virtual grants à la India?)
- How to share out limited foreign exchange resources among competing urgent domestic claimants (how far to improverish the diet in favor of enriching microprocessors?)

7. Western Leverage. In the present situation -- unlikely to change in the foreseeable future -- Western control of credit to the Eastern Bloc does seem to provide a plausible means of subtle leverage vis a vis Moscow. The possibility of achieving a common position among major Western lenders is probably greater on this issue than any other: the banks' faith in the Eastern Bloc's creditworthiness is badly shaken and they find themselves under less compulsion to expand their loan portfolios. Conversely, in the Soviet mind, the future of East-West trade is now, more than ever, dependent on the international financial community's continued support. This realization in itself may work to restrain Soviet actions. A basis for explicit or tacit understandings about some aspects of Soviet behavior, say in Poland, thus now exists.

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